

# **Legislative Audit Division**

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**State of Montana**



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**Report to the Legislature**

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**March 1997**

## **Financial-Compliance Audit**

**For the Two Fiscal Years Ended June 30, 1996**

## **Department of Natural Resources and Conservation**

**This report contains five recommendations. Issues addressed in the report include:**

- ▶ **Accounting for Internal Service Fund, Agency Fund & Nonexpendable Trust Fund activity in accordance with state law and accounting policy.**
- ▶ **Classification of a High Hazard Dam.**

**Direct comments/inquiries to:  
Legislative Audit Division  
Room 135, State Capitol  
PO Box 201705  
Helena MT 59620-1705**

## **FINANCIAL-COMPLIANCE AUDITS**

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act of 1984 and Amendments of 1996, and OMB Circular A-128 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 1995 has been issued. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator  
Office of Budget and Program Planning  
State Capitol  
Helena MT 59620  
Phone (406) 444-3616

Legislative Audit Division  
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PO Box 201705  
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# LEGISLATIVE AUDIT DIVISION

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James Gillett, Financial-Compliance Audit

March 1997

To the Legislative Audit Committee  
of the Montana State Legislature:

This is our financial-compliance audit report for the Department of Natural Resources and Conservation for the two fiscal years ending June 30, 1996. We issued a qualified opinion on the financial schedules of the department. Included in this report are five recommendations concerning accounting for activity in accordance with state policy and generally accepted accounting principles, and classifying dams in accordance with state laws and regulations. The department's response is included at the end of the report.

We thank the director and his staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

"Signature on File"

Scott A. Seacat  
Legislative Auditor

# **Legislative Audit Division**

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## **Financial-Compliance Audit**

**For the Two Fiscal Years Ended June 30, 1996**

## **Department of Natural Resources and Conservation**

Members of the audit staff involved in this audit were Brenda Bokovoy, Laurie Evans, John Fine, Wayne D. Guazzo, Frieda Houser, Scott Hoversland, and Paul J. O'Loughlin.

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## **Appointed and Administrative Officials**

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### **State Board of Land Commissioners**

Marc Racicot, Governor  
Mark O'Keefe, State Auditor  
Mike Cooney, Secretary of State  
Nancy Keenan, Superintendent of Public Instruction  
Joe Mazurek, Attorney General

### **Administrative Officials**

Arthur "Bud" Clinch, Director  
  
Randy Mosley, Special Assistant  
  
Wayne Wetzel, Special Projects Coordinator  
  
Ann Bauchman, Centralized Services Division Administrator  
  
Ray Beck, Conservation and Resource Development  
Division Administrator  
  
Don Artley, Forestry Division Administrator  
  
Tom Richmond, Oil & Gas Conservation Division Administrator  
  
Gary Fritz, Water Resource Division Administrator  
  
Susan Cottingham, Reserved Water Rights Compact Commission  
Program Manager  
  
Jeff Hagener, Trust Land Management Division Administrator

### **Administratively Attached Agencies & Boards**

Board of Water Well Contractors  
Board of Oil and Gas Conservation  
Reserved Water Rights Compact Commission  
Rangeland Resources Committee  
Drought Advisory Committee  
Water Pollution Control Advisory Council  
Community Service Advisory Council  
Resource Conservation Advisory Council



### **Department of Natural Resources and Conservation**

This audit report is the result of our financial-compliance audit of the Department of Natural Resources and Conservation for the two fiscal years ended June 30, 1996. The department underwent significant reorganization which was effective July 1, 1995. The former department's Energy Division was moved to the newly created Department of Environmental Quality (DEQ). All but the Reclamation Division of the former Department of State Lands was merged with the department.

This report contains five recommendations where the department could enhance compliance with state laws and policies. The major issues discussed concern compliance with state accounting laws and policy and classification of high hazard dams.

The first four individual recommendations discuss compliance with state accounting laws and policy and include:

- Internal Service Fund accounting and fees;
- Agency Fund accounting for property held in trust; and
- Nonexpendable Trust Fund accounting for investment and income activity.

The fifth recommendation discusses the department's classification of a high hazard dam. In our previous audit, we noted the department needed to obtain operating permits for 14 dams owned by the department. The department obtained permits for 13 of the 14 dams. However, instead of obtaining an operating permit for one dam, the department reclassified the dam from a high hazard dam to a dam not considered high hazard. The change was made through an internal rule change procedure that did not follow state law.

Department management concurred with the recommendations in the report.

We issued a qualified opinion on the financial schedules contained in this report. Because of the reorganization of the department, the financial activity of the former Department of State Lands was transferred to the department. However, land valued at \$49,398,756 recorded in the Nonexpendable Trust Fund was omitted. As a result, ending fund balance at June 30, 1996 in the Nonexpendable

## Report Summary

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Trust Fund is understated by this amount. Except for the omission of land, the readers may rely on the presented financial information.

The listing below serves as a means of summarizing the recommendations contained in the report, the department's response thereto, and a reference to the supporting comments.

### Recommendation #1

We recommend the department review the accounting for the Air Operations Bureau in the Internal Service Fund to ensure accounting for assets and rates charged for aircraft use are in accordance with state law and policy. . . . . Page 10

Department's Response: Concur. See page B-4.

### Recommendation #2

We recommend the department:

A. Properly distribute balances in uncleared collections accounts at fiscal year-end. . . . . Page 12

Department's Reponse: Concur. See page B-4.

B. Properly record property held in trust activity in the Agency Fund. . . . . Page 12

Department's Response: Concur. See page B-4.

### Recommendation #3

We recommend the department record earnings transactions in the Nonexpendable Trust Fund accounts in accordance with state accounting policy. . . . . Page 14

Department's Reponse: Concur. See page B-4.

### Recommendation #4

We recommend the department record common school permanent trust fund transfers in accordance with state accounting policy. . . . . Page 15

Department's Reponse: Concur. See page B-4.

## **Report Summary**

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### **Recommendation #5**

We recommend the department classify the Yellow Water Dam in compliance with state laws and regulations. . . . . Page 17

Department's Reponse: Concur. See page B-5.



# Introduction

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## Introduction

We performed a financial-compliance audit of the Montana Department of Natural Resources and Conservation (department) for fiscal years 1994-95 and 1995-96. The objectives of the audit were to:

1. Determine the department's compliance with applicable laws and regulations.
2. Make recommendations for improvement in the department's internal and management controls.
3. Determine if the department's financial schedules fairly present the results of its operations for the two fiscal years ended June 30, 1996.
4. Determine the implementation status of prior audit recommendations.

This report contains five recommendations addressing areas where the department could improve compliance with state laws and policies. Other concerns not having a significant effect on the successful operations of the department are not specifically included in this report, but have been discussed with management. In accordance with section 5-13-307, MCA, we analyzed and disclosed the cost, if significant, of implementing the recommendations made in this report.

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## Background

Chapter 418, Laws of 1995, reorganized the Department of Natural Resources and Conservation (DNRC) effective July 1, 1995. The new department has four divisions from the old DNRC, two divisions from the former Department of State Lands and one Centralized Services division composed of staff from both of the former agencies. The reorganized DNRC includes most of the functions of its predecessors, except those of the State Land's Reclamation Division and DNRC's Energy Division both of which were transferred to the Department of Environmental Quality.

The department is responsible for sustaining and improving the benefits derived from our water, soil, and rangeland; managing the state's trust land resources to produce revenues for trust beneficiaries; protecting Montana's natural resources from wildland fires

## Introduction

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through regulation and partnerships with federal, state, and local agencies; promoting conservation of oil and gas and preventing waste through regulation of exploration and production; and managing and assisting in the management of several grant and loan programs, including the renewable resource, reclamation and development, treasure state endowment, and wastewater revolving fund programs. The department is also responsible for promoting the stewardship of Montana's water, soil, forest, and rangeland resources and for regulating forest practices.

The department is organized in the following seven divisions:

The Centralized Services Division provides administrative and operational support to all divisions. Support services include: fiscal affairs; data processing; and personnel. The division coordinates information services and prepares publications for printing. Trust revenues are collected and distributed; oil, gas, and coal royalty audits are conducted; and ownership records for trust and nontrust lands are maintained.

The Conservation and Resource Development Division coordinates, supervises, and provides financial and technical assistance to Montana's 58 conservation districts and provides technical, financial, and administrative assistance to public and private entities to complete projects that put renewable resources to work, increase the efficiency with which natural resources are used, or solve recognized environmental problems.

The Forestry Division protects Montana's forested and nonforested lands from wildfires. It provides aviation and fire suppression services; operates a nursery to provide stock for shelterbelt, wind-break, wildlife habitat improvement and reclamation, and reforestation of state and private lands; and regulates forest practices and wildfire hazards created by logging or other forest management operations on state and private lands.

Oil and Gas Conservation Division consists of The Board of Oil and Gas Conservation which is attached to DNRC for administrative purposes. The quasi-judicial board consists of seven members. They administer the Montana oil and gas conservation laws to promote conservation and prevent waste in the recovery of these resources through the regulation of exploration for and production of our state's oil and gas. The board and its technical support staff issue drilling permits; classify wells; establish well spacing units and

land pooling orders; inspect drilling, production, and seismic operations; investigate complaints; conduct engineering studies; and collect and maintain well data and production information.

The Reserved Water Rights Compact Commission was created by the 1979 Montana Legislature as part of the water rights adjudication effort. The seven commissioners negotiate water rights with Indian Tribes and federal agencies to establish formal agreements on the amount of water to be allocated to each interest. Its staff provides support services such as historical and legal research and analysis of soils, vegetation, and hydrology. Prior to reorganization, the commission was organizationally a part of the Governor's Office.

The Trust Land Management Division is responsible for managing the surface and mineral resources of forest, grazing, agricultural, and other classified state trust lands to produce revenue for the benefit of Montana's public schools and other endowed institutions. The State Board of Land Commissioners oversees the administration of the state trust land in Montana, as directed by the Montana Constitution. The director is responsible, under the direction of the board, for administering the state trust land management functions vested in the department. The State Board of Land Commissioners consists of the Governor, Superintendent of Public Instruction, Secretary of State, Attorney General, and State Auditor.

The Water Resources Division is responsible for many programs associated with the use, development, and protection of Montana's water. It administers state-owned water resource projects, water rights, and water reservations. Its activities include interstate coordination of water issues, centralized water rights record keeping, state water planning, dam safety, floodplain management, and drought planning. The division also provides administrative support to the Board of Water Well Contractors, which adopts administrative rules regulating licenses and establishing minimum construction standards for water wells.

Field operations are performed for DNRC's various programs through 40 area, regional, unit, and field offices located throughout the state. Sixteen are from the Water Resources, Board of Oil and Gas Conservation, and Conservation and Resource Development Divisions. The other 24 are from the Forestry and Trust Land Management Divisions.

## **Introduction**

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# Prior Audit Recommendations

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## Prior Audit Recommendations

We performed an audit of the department for the two fiscal years ended June 30, 1994. The report contained six recommendations. The department concurred with all the recommendations. Of the six recommendations, the department implemented five and partially implemented one. The recommendation partially implemented concerned Dam Safety and is again discussed on page 15.

We performed an audit of the former Department of State Lands for the two fiscal years ended June 30, 1995. The report contained seven recommendations now applicable to the Department of Natural Resources and Conservation's operations, which we determined have been implemented.



# Findings and Recommendations

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## Internal Service Fund Accounting

The department accounts for the Forestry Division, Air Operations Bureau (bureau) in an Internal Service Fund (ISF). The bureau maintains three fixed wing aircraft and five helicopters to assist with firefighting efforts in the state. The current rates charged are: \$85 per hour for fixed wing aircraft; \$325 per hour each for two of the helicopters; and \$800 per hour each for three of the helicopters. The rates do not include any administrative or personal services costs such as pilots wages. The department receives a subsidy each year from the General Fund for these costs. In fiscal year 1995-96 the subsidy was \$337,500.

Section 17-8-101( 5), MCA, states: "Fees and charges for services deposited in the internal service fund type must be based upon commensurate costs." The statute further requires the Legislative Auditor to report on the reasonableness of the rates charged and on the fund equity balance during regularly scheduled audits. In addition, the statute requires all rates must be approved by the legislature in the general appropriations act. The following sections discuss our concerns regarding the rate calculations and the fund balance of the Air Operations Bureau.

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## Rate Basis

During our audit we noted the department's fees are not in compliance with the law. The department includes in its rate structure a provision for future major overhauls and unplanned, unscheduled maintenance to the aircraft which are above and beyond normal scheduled maintenance and repair. The department uses historical costs, manufacturer information, and FAA requirements, to develop the rates. The information used by the department appears logical; however, the process followed to establish the rate structure does not follow state law. Fuel, oil, and normal maintenance and repair are components of current cost. Future major overhauls and unplanned, unscheduled repairs are not a current cost until they are incurred. Under state policy major equipment improvements which extend the life of equipment in an ISF should be capitalized and depreciated over the life of the equipment. If the department capitalized and depreciated the major repairs, the cost of depreciation would be a component of the rate structure and would provide a source of funds for future major repairs and maintenance.

## Findings and Recommendations

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If the department followed state accounting policy, it could enhance the process to establish rates in compliance with state law.

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### Asset Basis

The department does not record any fixed assets (equipment) in the ISF. The department has office equipment, computers, and furniture used by the bureau which are not recorded as assets of the ISF. Of the eight aircraft maintained by the department, six were acquired under the Federal Excess Property program and title remains with the Federal Government. However, the use of the aircraft and improvements represent an asset of the department and should be recorded as such in the ISF. The value of the fixed wing aircraft is recorded in the General Fixed Asset Account Group even though state policy requires it be recorded in the ISF. The department has an investment in aircraft, major overhauls of aircraft (i.e. engines, rotors, transmissions, etc), office equipment, computers, and furniture used in the Bureau. Under state accounting policy, fixed assets belonging to the ISF should be recorded in the ISF. The department should record these assets in the ISF. When computing amounts for assets the department needs to consider valuation increases due to major overhauls/upgrades which increase the life expectancy of the assets and the depreciation related to those assets.

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### Fund Balance

The department's recorded fund balance is not an accurate presentation of its equity, because the rate and assets basis are not in compliance with state accounting policy, as discussed above. The department's fund balance fluctuates widely over time. The fluctuations in fund balance represents the build up and depletion of cash reserves due to the inclusion of future overhauls in the rate structure. Through the rate structure, the department is collecting cash for anticipated major overhauls in future periods. If the department followed state accounting policy by capitalizing and depreciating the major overhauls, the fund balance would be more stable. The fund balance would primarily consist of the undepreciated balance of the assets plus cash. The table below presents the ending fund balance of the past six years and illustrates how the fund balance has fluctuated.

## Findings and Recommendations

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**Table 1**

**Internal Service Fund Ending Fund Balance**

<u>Fiscal Year End</u>	<u>ISF Ending Fund Balance</u>
1991	\$204,730
1992	\$292,074
1993	\$153,356
1994	\$ 54,877
1995	\$167,297
1996	\$203,692

**Source:** Prepared by the Legislative Audit Division from audited information on the Statewide Budgeting and Accounting System.

The department is projecting an ending fund balance at fiscal year end 1997 of \$422,626. Current projections indicate the fund balance will begin declining again in fiscal 1998. Without a detailed analysis we cannot determine the potential effects on fund balance in the ISF because the department is not recording assets and depreciation expense.

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### Summary

Department personnel stated they believe the rates charged provide a reasonable basis to cover immediate costs and make provisions for future major overhauls and other unscheduled maintenance. However, if the department capitalized and depreciated the major repair items and included depreciation expense in their rate structure, the department would be in compliance with state accounting policy, which would provide funds for future repairs and maintenance. The rate structure established would be in compliance with state law.

As noted above, we believe not including assets and depreciation accounts for the growing fund balance. These issues will require an analysis by the department and possibly discussions with the Department of Administration, Accounting Bureau, to determine the rate structure and proper accounting presentation for the Air Operations Bureau in the ISF.

## Findings and Recommendations

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### **Recommendation #1**

**We recommend the department review the accounting for the Air Operations Bureau in the Internal Service Fund to ensure accounting for assets and rates charged for aircraft use are in accordance with state law and policy.**

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### **Improper Accounting for Agency Fund Activity**

Generally accepted accounting principles (GAAP) and state accounting policy define fiduciary funds as trust and agency funds used to account for assets held by a governmental unit in a trustee capacity or as an agent for others. An Agency Fund is one type of fund within the fiduciary fund type. Agency funds are purely custodial in nature and do not involve measurements of revenue and expenditure activity.

The department records uncleared collections, property held in trust (PHIT), protested oil & gas royalties, and non-trust land activity in its Agency Funds. Uncleared collections activity occurs mainly because of the volume of money received for activities on trust lands. The department initially deposits money received into the Agency Fund. After a determination is made as to which trust receives the income, a distribution is done from uncleared collections to the various trust funds and other funds as appropriate. Property held in trust activity relates to security deposits and performance bonds which the department holds to ensure satisfactory performance by independent contractors performing work for the department and to ensure proper cleanup of logging operations. Protested oil & gas royalties are held pending resolution of disputes. The non-trust land activity relates to rental, lease, and royalty money collected by the department and forwarded to other state agencies. During our review of the Agency Fund activity at the department, we identified areas where compliance with state accounting policy could be improved. The following sections address our findings.

## **Findings and Recommendations**

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### **Undistributed Balances**

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At fiscal year-end 1995-96, the department had two accounts (Foresters Uncleared Collections and State Lands Uncleared Collections) within the Agency Fund which contained undistributed amounts of \$581,566 and \$5,822 respectively. These amounts included money which should eventually be distributed to the trust funds and amounts that represent bid deposits, and performance bonds. Bid deposits, and performance bond activity represent property held in trust and may be retained or returned based on the bid award or acceptable performance of a contract.

At fiscal year-end 1995-96, the department processed a transaction to move the amount of uncleared collections to a deposits payable account. Each year the Department of Administration, Accounting Bureau, publishes a memo describing accounting procedures for agencies to follow at fiscal year-end. The memo states amounts recorded in uncleared collections should be distributed. Simply moving the uncleared collections balance to a deposit payable account does not accomplish a distribution and misrepresents the nature of the activity. A reasonable estimate should be made for the amounts remaining in uncleared collections at year end which will eventually go to the trust funds and revenue recorded in the appropriate trust fund. In the next year, transactions could be processed, if necessary, to correct the estimate. Amounts held for bid deposits and performance bonds should be properly recorded as deposits payable or PHIT.

### **Identity of Property Held in Trust**

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State accounting policy provides for the financial presentation of Agency Funds to include additions and deletions to PHIT. In some accounts the department records detail activity for the security deposits and performance bonds on the state's accounting system. In the two accounts mentioned above, the department does not identify the differences in activity relating to PHIT and the clearing account activity. In the Foresters uncleared collections account, the department processed \$6,654,873 of additions and \$6,073,216 of deletions to PHIT. In the State Lands uncleared collections account, the department processed \$27,275,182 of additions and \$27,229,209 of deletions to PHIT. We estimate 94 percent of the amounts in each fund relate to clearing account activity. The state's accounting system provides methods, which the department already uses in

## Findings and Recommendations

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other Agency Fund accounts, to distinguish between the clearing account and PHIT activities. The department should segregate the two types of activities or establish separate accounts to record the two types of activity.

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### Recording Revenues and Expenditures

In one Agency Fund account, the department records lease, rental, and royalty activity on non-trust lands owned by other state agencies. Department staff noted that accepted practice allowed for recording revenues and expenditures in an Agency Fund; however, as mentioned previously, state policy allows only assets and liabilities representing custodial activity to be presented in an Agency Fund.

Section 17-1-102 (4), MCA, requires all state agencies to input necessary transactions before the end of the fiscal year to present the receipt, use, and disposition of all money and property under the agency's control in accordance with GAAP. The department should analyze the activity in its Agency Fund and work with the Department of Administration, Accounting Bureau, to ensure Agency Fund activity is recorded properly.

### **Recommendation #2**

**We recommend the department:**

- A. Properly distribute balances in uncleared collections accounts at fiscal year-end.**
- B. Properly record property held in trust activity in the Agency Fund.**

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### Recording All Investment Earnings In Non-expendable Trust Fund Accounts

The department has ten permanent trust accounts in the Non-expendable Trust Fund in addition to a pooled investment account (the Trust and Legacy Account). The available cash in the ten permanent trust accounts is moved to the pooled investment account. The Montana Board of Investments (BOI) invests the cash in securities and records investment earnings as revenue in the pooled investment account. Subsequently, the investment earnings are



## **Findings and Recommendations**

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distributed to the proper permanent trust fund by recording a nonbudgeted transfer-out in the investment pool account and a nonbudgeted transfer-in in the respective trust accounts. The income in each permanent trust account is distributed to the respective beneficiaries (i.e. colleges, universities, institutions, and public schools).

At the end of each fiscal year, BOI accrues investment earnings for income earned but not yet collected. Department personnel transfer this income from the pooled investment account directly to the respective beneficiaries. By recording the activity directly to the beneficiaries, the accrued income is not recorded in the ten permanent trust fund accounts. The revenue must first be recorded in the earning account before being distributed to the respective beneficiaries.

Department personnel believe the amounts recorded in the ten permanent trust fund accounts represents the amount of money that has been distributed to the beneficiaries and said this is the way they have been recording the accrued investment earnings activity for over ten years. The current recording procedure results in the activity in the ten permanent trust fund accounts being recorded on the cash basis of accounting. State accounting policy requires accounts in the Nonexpendable Trust Fund to be on the full accrual basis of accounting. The department's failure to record the accruals results in a net effect of overstating transfers-in and transfers-out in the Nonexpendable Trust Fund ten permanent trust fund accounts in total by \$4, 473,111 for fiscal year 1995-96. The department should record accrued revenue in the ten permanent trust fund accounts to ensure it is reported on the full accrual basis of accounting.

The department assists the Department of Administration in managing a Nonexpendable Trust Fund account called the Coal Severance Tax School Bond Contingency Loan fund. This account has money invested by BOI, but the investment earnings are not recorded in the account. Department personnel indicated since an account managed by the Department of Revenue (DOR) is entitled to receive the revenue, they set up the account to automatically record the revenue on the DOR books. However, state accounting policy

## Findings and Recommendations

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requires the trust fund revenues to first be recorded in the earning account before being transferred to the account that is entitled to receive the revenue.

### **Recommendation #3**

We recommend the department record earnings transactions in the Nonexpendable Trust Fund accounts in accordance with state accounting policy.

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### **Common School Permanent Trust Fund Activity Overstated**

The department processes transactions on the state's accounting records to move 95 percent of income in the Common School Permanent Trust Fund to the General Fund for the payment of school equalization aid. The income is recorded as a transfer-out from the Common School Permanent Trust Fund and a corresponding transfer-in to the General Fund. In accordance with the Montana Constitution, the remaining 5 percent of income remains in the Common School Permanent Trust Fund. When the transactions are recorded, department personnel also create a transfer-in and transfer-out for the 5 percent of the money that is to remain in the Common School Permanent Trust Fund accounting entity. The Department of Administration's Accounting Bureau personnel indicate recording a transfer-out and transfer-in within the same accounting entity is not proper. Transfers-in and transfers-out are each overstated by \$2,212,199 in the Nonexpendable Trust Fund because of the double recording of transfers within the same accounting entity.

The income collected had already been recorded in the Common School Permanent Trust Fund when initially collected. When the 95 percent is transferred out, the balance remaining in the accounting entity for income collected should represent the 5 percent retained. A department official stated the reason he records the transfer-in and out is so users of the accounting records can easily track the amount that represents the 5 percent of income remaining in the account since it is shown as a separately identifiable amount.

## Findings and Recommendations

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### **Recommendation #4**

**We recommend the department record Common School Permanent Trust Fund transfers in accordance with state accounting policy.**

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### **Improper Reclassification of a State Owned Dam**

In our prior audit of the department, we noted 14 of 26 dams owned by the department needed to obtain operating permits. The department properly obtained operating permits for all of the dams except for the Yellow Water Dam in Petroleum County. The following paragraphs discuss the dam monitoring procedures used by the department.

The department's Water Resources Division (division) is responsible for managing the state's water resources. Within the division, the State Water Projects Bureau is responsible for the operation, management, and rehabilitation of state-owned dams. The Water Operations Bureau of the division operates the dam safety program which issues operating permits for all high hazard dams. State law defines a dam or reservoir as high hazard if the impoundment capacity is 50 acre feet or more at the maximum normal operating pool, and the failure of which would likely cause loss of life. Section 85-15-212, MCA, requires dams designated as high hazard to have an operating plan prepared by the owner and approved by the department. The operating plan must include reservoir operation procedures, maintenance procedures, emergency procedures and warning plans. In addition, section 85-15-213, MCA, states a high hazard dam must be inspected as often as considered necessary by the department, but at least once every five years.

In 1988, the department adopted rules which define loss of life as likely to occur if dam failure would cause structures such as occupied houses and farm buildings, stores, gas stations, parks, golf courses, stadiums, ball parks, and paved highways to be flooded. This rule has not been changed since 1988. If the Yellow Water Dam failed, the flooded area would include highway 244 between

## **Findings and Recommendations**

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Roundup and Winnett. Since this is a paved highway, the dam meets the current definition of a high hazard dam.

The Water Operations Bureau inappropriately initiated an internal rule change through an internal memorandum dated September 15, 1992. The department proposed to change the definition of paved highways in the rules to "roads with an average daily traffic count greater than 200." On January 13, 1995 the bureau used this definition to reclassify the Yellow Water Dam from a high hazard dam to a dam that is not considered high hazard. Dams not designated as high hazard are not regulated by the department.

The internal rule change does not comply with state law. The Montana Administrative Procedure Act defined in state law requires an agency give written notice of their intended action and file it with the Secretary of State prior to the adoption of any rule amendments. Section 2-4-305(7), MCA, states a rule is not valid unless it is adopted in substantial compliance with the Montana Administrative Procedure Act.

If the department had complied with state law and initiated a valid rule change; it still did not follow its average daily traffic criteria. The department did not use the most current information available from the Department of Transportation for determining average daily traffic counts. In 1995, when they improperly used the memorandum to reclassify the dam, more current information was available on traffic counts. The department used 1991 as a basis for the average daily traffic counts. As the table below shows, in 1992, 1993, and 1995 the reclassification does not meet the department's own proposed criteria and should have remained designated as high hazard.

## Findings and Recommendations

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Table 2				
<b><u>Highway 244 Average Daily Traffic Count between Roundup and Winnett Montana</u></b>				
<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>
154	212	245	196	231
<b>Source: Montana Department of Transportation in Cooperation with the U.S. Department of Transportation.</b>				

A department official stated they have new technology to evaluate the effects if the dam were to fail. Department Officials further stated this new analysis would determine the proper classification of the dam.

### **Recommendation #5**

**We recommend the department classify the Yellow Water Dam in compliance with state laws and regulations.**



# **Independent Auditor's Report & Agency Financial Schedules**

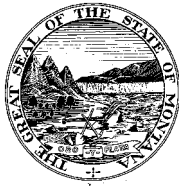
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# LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor  
John W. Northey, Legal Counsel  
Tori Hunthausen, IT & Operations Manager



Deputy Legislative Auditors:  
Jim Pellegrini, Performance Audit  
James Gillett, Financial-Compliance Audit

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying financial schedules of the Department of Natural Resources and Conservation for each of the two fiscal years ended June 30, 1995 and 1996, as shown on pages A-5 through A-21. The information contained in these financial schedules is the responsibility of the department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the financial schedules are presented on a comprehensive basis of accounting other than generally accepted accounting principles. The schedules are not intended to be a complete presentation and disclosure of the department's assets, liabilities and cash flows.

As described in note 5, the department was reorganized in fiscal year 1995-96. The Nonexpendable Trust Funds at the former Department of State Lands were transferred to the department. In recording the reorganization, the value of the land of the trust funds was omitted. As a result of this omission, direct entries to fund balance for fiscal year 1995-96 and fund balance at June 30, 1996 are each understated by \$49,398,756 in the Nonexpendable Trust Fund on the Schedule of Changes in Fund Balance & Property Held in Trust.

In our opinion, except for the omission in recording the land and the related impact on fund balance as described in the previous paragraph, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances and property held in trust of the Department of Natural Resources and Conservation for the two fiscal years ended June 30, 1995 and 1996, in conformity with the basis of accounting described in note 1.

Respectfully submitted,

“Signature on File”

James Gillett, CPA  
Deputy Legislative Auditor

January 7, 1997

DEPARTMENT OF NATURAL RESOURCES & CONSERVATION  
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST  
FOR THE TWO FISCAL YEARS ENDED JUNE 30, 1996

	General Fund	Special Revenue Funds	Debt Service Funds	Capital Projects Funds	Internal Service Funds	Agency Funds	Expendable Trust Funds	Nonexpendable Trust Funds
FUND BALANCE: July 1, 1994	\$ 0	\$ 26,663,886	\$ 44,104,768	\$ 0	\$ 0		\$ 1,242,757	\$ 2,166,606
PROPERTY HELD IN TRUST: July 1, 1994						\$ 0		
ADDITIONS								
<u>Fiscal Year 1994-95</u>								
Budgeted Revenues & Transfers-In	5,209	8,652,610						
<sup>3</sup> Nonbudgeted Revenues & Transfers-In	32,363	5,535,406	7,739,806				86,352	(13,519)
<sup>2</sup> Cash Transfers-In		4,562,903	396,003					
Prior Year Revenue Adjustments			1,272					
Prior Year Transfers-In Adjustments		(82,000)						
Prior Year Expenditure Adjustments	2,887	336,068						
<sup>4</sup> Direct Entries to Fund Balance	3,184		886,914					
Support From State of Montana	3,170,441							
Additions to Property Held in Trust						635,569		
<u>Fiscal Year 1995-96</u>								
Budgeted Revenues & Transfers-In	42,413,058	28,273,633			515,909			
<sup>3</sup> Nonbudgeted Revenues & Transfers-In	126,482	4,841,428	20,354,264					88,699,879 <sup>1</sup>
<sup>2</sup> Cash Transfers-In		5,735,151	346,940	64,026				1,085,685
Prior Year Revenue Adjustments			22,840					
Prior Year Expenditure Adjustments		54,188						
<sup>4</sup> Direct Entries to Fund Balance	13,054,229		3,728,351		167,298			292,337,428
Additions to Property Held in Trust						39,789,586		
Total Additions	<u>58,807,853</u>	<u>57,909,387</u>	<u>33,476,390</u>	<u>64,026</u>	<u>683,207</u>	<u>40,425,155</u>	<u>86,352</u>	<u>382,109,473</u>
REDUCTIONS								
<u>Fiscal Year 1994-95</u>								
Budgeted Expenditures & Transfers-Out	3,214,335	14,214,758					86,514	
Prior Year Expenditures	(273)	73,555					303	
<sup>3</sup> Nonbudgeted Expenditures & Transfers-Out		1,495,010	9,687,479					
Nonbudgeted Prior Year Transfer-Out Adjustments								
Cash Transfers-Out								119
Prior Year Transfer-Out Adjustments		(132,587)						
<sup>4</sup> Direct Entries to Fund Balance		923,674						
Prior Year Revenue Adjustments	22	245,120					55	
Reductions to Property Held in Trust						635,569		

Fiscal Year 1995-96								
Budgeted Expenditures & Transfers-Out	14,615,156	15,724,345		45,743	469,873			
Prior Year Expenditures		128,797						
Support to State of Montana	40,928,532							
<sup>3</sup> Nonbudgeted Expenditures & Transfers-Out		14,260,627	22,939,710		(1,981)			77,870,401
Prior Year Expenditure Adjustments	16,359				11,623			
<sup>2</sup> Cash Transfers-Out						1,241,884		
<sup>4</sup> Direct Entries to Fund Balance		151,552		22,592		353		
Prior Year Transfer-Out Adjustments		63,520						
Prior Year Revenue Adjustments	33,722	21,070						
Reductions to Property Held in Trust						36,066,103		
Total Reductions	<u>58,807,853</u>	<u>47,169,441</u>	<u>32,627,189</u>	<u>68,335</u>	<u>479,515</u>	<u>36,701,672</u>	<u>1,329,109</u>	<u>77,870,520</u>
FUND BALANCE: June 30, 1996	\$ <u>0</u>	\$ <u>37,403,832</u>	\$ <u>44,953,969</u>	\$ <u>(4,309)</u>	\$ <u>203,692</u>		\$ <u>0</u>	\$ <u>306,405,559</u>
PROPERTY HELD IN TRUST: June 30, 1996						\$ <u>3,723,483</u>		

<sup>1</sup> See note 7 on page A-19.  
<sup>2</sup> See note 8 on page A-20.  
<sup>3</sup> See note 9 on page A-20.  
<sup>4</sup> See note 6 on page A-18.

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules beginning on page A-15.

DEPARTMENT OF NATURAL RESOURCES & CONSERVATION  
SCHEDULE OF TOTAL REVENUES, TRANSFERS-IN & OTHER ADDITIONS  
FOR THE FISCAL YEAR ENDED JUNE 30, 1996

	General Fund	Special Revenue Funds	Debt Service Funds	Internal Service Funds	Nonexpendable Trust Funds	Total
TOTAL REVENUES BY CLASS						
Licenses & Permits	\$ 49,620	\$ 59,122			\$ 339,827	\$ 448,569
Taxes		1,547,266				1,547,266
Charges for Services	385,992	2,355,996	\$ 877	\$ 178,409		2,921,274
Investment Earnings	292	579,755	2,793,224		26,442,009	29,815,280
Fines & Forfeits	500	142,382				142,882
Federal Indirect Cost Recoveries	19,294	88,337				107,631
Sale of Documents & Merchandise	775	1,636,580	1,847,319		3,781,638	7,266,312
Rentals, Leases & Royalties	9,839	20,087			25,947,380	25,977,306
Miscellaneous	6,718	28,666				35,384
Grants, Contracts & Donations	987	74,875				75,862
Other Financing Sources	42,031,801	23,898,700	15,735,684	337,500	32,189,025	114,192,710
Federal		2,662,225				2,662,225
Total Revenues	<u>42,505,818</u>	<u>33,093,991</u>	<u>20,377,104</u>	<u>515,909</u>	<u>88,699,879</u>	<u>185,192,701</u>
Less: Nonbudgeted Revenues & Transfers-In	126,482	4,841,428 <sup>2</sup>	20,354,264 <sup>2</sup>		88,699,879 <sup>1</sup>	114,022,053
Prior-Year Revenues & Transfers-In Adjustments	<u>(33,722)</u>	<u>(21,070)</u>	<u>22,840</u>			<u>(31,952)</u>
Actual Budgeted Revenues & Transfers-In	42,413,058	28,273,633	0	515,909	0	71,202,600
Estimated Revenues	39,053,589	68,088,056		587,500		107,729,145
Budgeted Revenues Over (Under) Estimated	<u>\$ 3,359,469</u>	<u>\$ (39,814,423)</u>	<u>\$ 0</u>	<u>\$ (71,591)</u>	<u>\$ 0</u>	<u>\$ (36,526,545)</u>
BUDGETED REVENUES OVER(UNDER) ESTIMATED BY CLASS						
Licenses & Permits		\$ (340,878)				\$ (340,878)
Taxes		(54,742)				(54,742)
Charges for Services	\$ 179,863	(423,989)		\$ (71,591)		(315,717)
Investment Earnings		(43,035)				(43,035)
Fines & Forfeits		13,808				13,808
Federal Indirect Cost Recoveries	7,294	42,152				49,446
Sale of Documents & Merchandise		(63,936)				(63,936)
Rentals, Leases & Royalties		(32,106)				(32,106)
Miscellaneous		5,232				5,232
Grants, Contracts & Donations		(1,620,414)				(1,620,414)
Other Financing Sources	3,172,312	(11,712,427) <sup>3</sup>				(8,540,115)
Federal		(25,584,088) <sup>3</sup>				(25,584,088)
Budgeted Revenues Over (Under) Estimated	<u>\$ 3,359,469</u>	<u>\$ (39,814,423)</u>		<u>\$ (71,591)</u>		<u>\$ (36,526,545)</u>

<sup>1</sup> See note 7 on page A-19.

<sup>2</sup> See note 9 on page A-20.

<sup>3</sup> See note 11 on page A-21.

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules beginning on page A-15.

DEPARTMENT OF NATURAL RESOURCES & CONSERVATION  
SCHEDULE OF TOTAL REVENUES, TRANSFERS-IN & OTHER ADDITIONS  
FOR THE FISCAL YEAR ENDED JUNE 30, 1995

	General Fund	Special Revenue Funds	Debt Service Funds	Expendable Trust Funds	Nonexpendable Trust Funds	Total
TOTAL REVENUES BY CLASS						
Licenses & Permits		\$ 18,650				\$ 18,650
Charges for Services	\$ 27,925	631,231	\$ 986			660,142
Investment Earnings	198	546,343	3,089,568	\$ 76,297	\$ (50)	3,712,356
Fines & Forfeits	3,332	61,668				65,000
Federal Indirect Cost Recoveries	(100)	72,139				72,039
Sale of Documents & Merchandise	697	626,396	1,890,664			2,517,757
Rentals, Leases & Royalties		18,991				18,991
Miscellaneous	50	5,980				6,030
Grants, Contracts & Donations		58,814		10,000		68,814
Other Financing Sources	5,448	11,096,646	2,759,860		(13,469)	13,848,485
Federal		724,038				724,038
Total Revenues	<u>37,550</u>	<u>13,860,896</u>	<u>7,741,078</u>	<u>86,297</u>	<u>(13,519)</u>	<u>21,712,302</u>
Less: Nonbudgeted Revenues & Transfers-In	32,363	5,535,406 <sup>1</sup>	7,739,806 <sup>1</sup>	86,352	(13,519)	13,380,408
Prior-Year Revenues & Transfers-In Adjustments	(22)	(327,120)	1,272	(55)		(325,925)
Actual Budgeted Revenues & Transfers-In	<u>5,209</u>	<u>8,652,610</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>8,657,819</u>
Estimated Revenues	<u>6,612</u>	<u>8,950,651</u>				<u>8,957,263</u>
Budgeted Revenues Over (Under) Estimated	\$ <u>(1,403)</u>	\$ <u>(298,041)</u>	\$ <u>0</u>	\$ <u>0</u>	\$ <u>0</u>	\$ <u>(299,444)</u>
BUDGETED REVENUES OVER(UNDER) ESTIMATED BY CLASS						
Licenses & Permits		\$ (276,350)				\$ (276,350)
Charges for Services	\$ (1,403)	33,847				32,444
Investment Earnings		40,281				40,281
Fines & Forfeits		(1)				(1)
Federal Indirect Cost Recoveries		4,944				4,944
Sale of Documents & Merchandise		63,685				63,685
Rentals, Leases & Royalties		7,042				7,042
Grants, Contracts & Donations		(47,619)				(47,619)
Other Financing Sources		313,177				313,177
Federal		(437,047)				(437,047)
Budgeted Revenues Over (Under) Estimated	\$ <u>(1,403)</u>	\$ <u>(298,041)</u>				\$ <u>(299,444)</u>

<sup>1</sup> See note 9 on page A-20.

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules beginning on page A-15.



DEPARTMENT OF NATURAL RESOURCES & CONSERVATION  
SCHEDULE OF TOTAL EXPENDITURES, TRANSFERS-OUT & OTHER REDUCTIONS BY OBJECT BY PROGRAM  
FOR THE FISCAL YEAR ENDED JUNE 30, 1996

	Trust Funds	Trust Land Management Division	Centralized Services Division	Oil & Gas Conservation Division	Conservation/ Resource Development Division	Water Resources Division	Reserved Water Rights Compact Commission	Forestry Division	Total
PROGRAM EXPENDITURES BY OBJECT									
Personal Services									
Salaries		\$ 2,788,484	\$ 1,316,304	\$ 407,620	\$ 515,686	\$ 3,229,593	\$ 340,344	\$ 3,190,877	\$ 11,788,908
Hourly Wages		201,095	2,902					1,318,468	1,522,465
Other Compensation				4,500	350	400	4,089		9,339
Employee Benefits		762,796	341,684	104,744	129,612	822,081	82,877	1,038,895	3,282,689
Personal Services-Other								(1,981)	(1,981)
Total		<u>3,752,375</u>	<u>1,660,890</u>	<u>516,864</u>	<u>645,648</u>	<u>4,052,074</u>	<u>427,310</u>	<u>5,546,259</u>	<u>16,601,420</u>
Operating Expenses									
Services		612,696	303,349	401,163	303,109	3,406,143	23,073	1,299,042	6,348,575
Supplies & Materials		218,841	31,278	15,867	17,962	110,299	8,382	607,451	1,010,080
Communications		79,044	75,044	28,247	25,446	141,815	6,403	184,748	540,747
Travel		68,476	15,858	15,275	46,792	96,260	21,823	96,771	361,255
Rent		227,065	300,878	10,200	7,720	116,360	692	312,658	975,573
Utilities		10,329	11,545	7,514	643	10,686		102,727	143,444
Repair & Maintenance		88,018	36,776	7,053	4,518	116,791	3,127	572,606	828,889
Other Expenses		25,522	29,147	5,666	20,075	167,384	4,093	59,718	311,605
Total		<u>1,329,991</u>	<u>803,875</u>	<u>490,985</u>	<u>426,265</u>	<u>4,165,738</u>	<u>67,593</u>	<u>3,235,721</u>	<u>10,520,168</u>
Equipment and Intangible Assets									
Equipment		378,236	34,973	23,820	36,551	142,581	10,730	518,413	1,145,304
Intangible Assets		279	4,964	146	1,302	11,838	1,362	2,905	22,796
Total		<u>378,515</u>	<u>39,937</u>	<u>23,966</u>	<u>37,853</u>	<u>154,419</u>	<u>12,092</u>	<u>521,318</u>	<u>1,168,100</u>
Capital Outlay									
Land & Interest in Land		2,740				5,000			7,740
Buildings								4,310	4,310
Total		<u>2,740</u>				<u>5,000</u>		<u>4,310</u>	<u>12,050</u>
Local Assistance									
From State Sources					125,000				125,000
Total					<u>125,000</u>				<u>125,000</u>
Grants									
From State Sources			496,594		1,004,048				1,500,642
Total			<u>496,594</u>		<u>1,004,048</u>				<u>1,500,642</u>

Transfers																		
Accounting Entity Transfers	\$	77,870,401	<sup>1</sup>		16,480,387	(1,594)		337,500	94,686,694									
Total		<u>77,870,401</u>			<u>16,480,387</u>	<u>(1,594)</u>		<u>337,500</u>	<u>94,686,694</u>									
Debt Service																		
Bonds					20,704,994	561,891			21,266,885									
Loans						59,169			59,169									
Leases			9,013	654	3,362	6,911	1,121		21,061									
Total			<u>9,013</u>	<u>654</u>	<u>20,708,356</u>	<u>627,971</u>	<u>1,121</u>		<u>21,347,115</u>									
Total Program Expenditures	\$	<u>77,870,401</u>	\$	<u>5,463,621</u>	\$	<u>3,010,309</u>	\$	<u>1,032,469</u>	\$	<u>39,427,557</u>	\$	<u>9,003,608</u>	\$	<u>508,116</u>	\$	<u>9,645,108</u>	\$	<u>145,961,189</u>

PROGRAM EXPENDITURES BY FUND

General Fund	\$	3,043,730	\$	2,346,788	\$	115,085	\$	2,944,621	\$	218,307	\$	5,962,984	\$	14,631,515
Special Revenue Fund		2,419,891		662,226	\$	1,032,469		16,934,652		5,497,096		289,809		3,158,161
Debt Service Fund								22,377,820		561,891				22,939,711
Capital Projects Fund				1,295								44,449		45,744
Internal Service Fund												479,514		479,514
Nonexpendable Trust Fund	\$	77,870,401												77,870,401
Total Program Expenditures		<u>77,870,401</u>		<u>5,463,621</u>		<u>3,010,309</u>		<u>1,032,469</u>		<u>39,427,557</u>		<u>9,003,608</u>		<u>508,116</u>
												<u>9,645,108</u>		<u>145,961,189</u>
Less: Nonbudgeted Expenditures & Transfers-Out		77,870,401		2,174				36,635,166		562,998			(1,981)	115,068,758
Prior-Year Expenditure &														
Transfers-Out Adjustments			9,805	(6,677)		(4,812)		9,127		(8,630)		92	38,409	37,314
Actual Budgeted Expenditures & Transfers-Out			5,453,816	3,014,812		1,037,281		2,783,264		8,449,240		508,024	9,608,680	30,855,117
Budget Authority			5,862,530	3,181,169		2,676,307		7,024,812		42,999,822		512,048	9,889,954	72,146,642
Unspent Budget Authority	\$	<u>0</u>	\$	<u>408,714</u>	\$	<u>166,357</u>	\$	<u>1,639,026</u>	\$	<u>4,241,548</u>	\$	<u>34,550,582</u>	\$	<u>4,024</u>
												<u>281,274</u>	\$	<u>41,291,525</u>

UNSPENT BUDGET AUTHORITY BY FUND

General Fund	\$	44,349	\$	152,513	\$	1,003	\$	27,287	\$	506	\$	29,235	\$	254,893		
Special Revenue Fund		364,365		7,570	\$	1,639,026		4,240,545		34,523,295 <sup>2</sup>		3,518		186,558	40,964,877	
Capital Projects Fund				6,274										55,952	62,226	
Internal Service Fund														9,529	9,529	
Total Unspent Budget Authority	\$	<u>408,714</u>	\$	<u>166,357</u>	\$	<u>1,639,026</u>	\$	<u>4,241,548</u>	\$	<u>34,550,582</u>	\$	<u>4,024</u>	\$	<u>281,274</u>	\$	<u>41,291,525</u>

<sup>1</sup> See note 7 on page A-19.  
<sup>2</sup> See note 11 on page A-21.

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules beginning on page A-15.

DEPARTMENT OF NATURAL RESOURCES & CONSERVATION  
SCHEDULE OF TOTAL EXPENDITURES, TRANSFERS-OUT & OTHER REDUCTIONS BY OBJECT BY PROGRAM  
FOR THE FISCAL YEAR ENDED JUNE 30, 1995

PROGRAM EXPENDITURES BY OBJECT	Centralized Services Division	Oil & Gas Regulation Division	Conservation Resource Development Division	Water Resources Division	Reserved Water Rights Compact Division	Energy Division	Total
Personal Services							
Salaries	\$ 951,861	\$ 408,884	\$ 509,685	\$ 3,168,672	\$ 337,438	\$ 970,070	\$ 6,346,610
Other Compensation	2,575	4,075	525	1,450	4,284	228	13,137
Employee Benefits	237,223	110,537	134,684	840,762	84,904	249,073	1,657,183
Total	<u>1,191,659</u>	<u>523,496</u>	<u>644,894</u>	<u>4,010,884</u>	<u>426,626</u>	<u>1,219,371</u>	<u>8,016,930</u>
Operating Expenses							
Services	100,892	511,810	240,140	1,629,718	18,909	410,033	2,911,502
Supplies & Materials	12,994	17,053	8,828	79,123	4,462	33,878	156,338
Communications	22,654	28,443	25,359	136,306	5,956	28,097	246,815
Travel	11,550	17,391	46,285	93,876	18,021	56,816	243,939
Rent	267,233	9,600	6,387	88,653	554	1,828	374,255
Utilities		7,410	645	7,362			15,417
Repair & Maintenance	29,199	13,095	3,974	36,342	4,639	5,599	92,848
Other Expenses	23,386	1,630	43,264	43,327	3,521	26,433	141,561
Total	<u>467,908</u>	<u>606,432</u>	<u>374,882</u>	<u>2,114,707</u>	<u>56,062</u>	<u>562,684</u>	<u>4,182,675</u>
Equipment and Intangible Assets							
Equipment	19,218	4,145	22,527	137,701	9,215	35,245	228,051
Intangible Assets	1,188	448	1,160	7,631	1,126	6,385	17,938
Total	<u>20,406</u>	<u>4,593</u>	<u>23,687</u>	<u>145,332</u>	<u>10,341</u>	<u>41,630</u>	<u>245,989</u>
Capital Outlay							
Land & Interest in Land				91,378		65,070	156,448
Total				<u>91,378</u>		<u>65,070</u>	<u>156,448</u>
Local Assistance							
From State Sources			105,000				105,000
Total			<u>105,000</u>				<u>105,000</u>
Grants							
From State Sources			2,036,485	(25,372)		432,896	2,444,009
From Federal Sources						2,400	2,400
Total			<u>2,036,485</u>	<u>(25,372)</u>		<u>435,296</u>	<u>2,446,409</u>
Transfers							
Accounting Entity Transfers			4,424,865	3,373		765,506	5,193,744

Total			<u>4,424,865</u>	<u>3,373</u>		<u>765,506</u>	<u>5,193,744</u>
Debt Service							
Bonds			6,943,689	589,004		230,531	7,763,224
Loans				92,971			92,971
Leases	<u>6,071</u>	<u>654</u>	<u>3,362</u>	<u>6,911</u>	<u>1,121</u>	<u>5,044</u>	<u>23,163</u>
Total	<u>6,071</u>	<u>654</u>	<u>6,947,051</u>	<u>688,886</u>	<u>1,121</u>	<u>235,575</u>	<u>7,879,358</u>
Total Program Expenditures	\$ <u>1,686,044</u>	\$ <u>1,135,175</u>	\$ <u>14,556,864</u>	\$ <u>7,029,188</u>	\$ <u>494,150</u>	\$ <u>3,325,132</u>	\$ <u>28,226,553</u>
PROGRAM EXPENDITURES BY FUND							
General Fund	\$ 756,727			\$ 1,949,848	\$ 5,448	\$ 499,425	\$ 3,211,448
Special Revenue Fund	929,317	\$ 1,135,175	\$ 5,804,388	4,490,336	488,702	2,393,194	15,241,112
Debt Service Fund			8,752,476	589,004		345,999	9,687,479
Expendable Trust Fund						86,514	86,514
Total Program Expenditures	<u>1,686,044</u>	<u>1,135,175</u>	<u>14,556,864</u>	<u>7,029,188</u>	<u>494,150</u>	<u>3,325,132</u>	<u>28,226,553</u>
Less: Nonbudgeted Expenditures & Transfers-Out			10,234,345	589,004		359,140	11,182,489
Prior-Year Expenditure Adjustments & Transfers-Out	(1,617)	(46,666)	(350,728)	(13,824)	1,808	(60,516)	(471,543)
Actual Budgeted Expenditures & Transfers-Out	1,687,661	1,181,841	4,673,247	6,454,008	492,342	3,026,508	17,515,607
Budget Authority	<u>1,717,560</u>	<u>2,128,899</u>	<u>5,542,335</u>	<u>22,038,112</u>	<u>497,125</u>	<u>7,098,619</u>	<u>39,022,650</u>
Unspent Budget Authority	\$ <u>29,899</u>	\$ <u>947,058</u>	\$ <u>869,088</u>	\$ <u>15,584,104</u>	\$ <u>4,783</u>	\$ <u>4,072,111</u>	\$ <u>21,507,043</u>
UNSPENT BUDGET AUTHORITY BY FUND							
General Fund	\$ 29,772			\$ 365	\$ 4,552	\$ 49,423	\$ 84,112
Special Revenue Fund	127	\$ 947,058	\$ 869,088	15,583,739 <sup>1</sup>	231	3,936,472	21,336,715
Expendable Trust Fund						86,216	86,216
Total Unspent Budget Authority	\$ <u>29,899</u>	\$ <u>947,058</u>	\$ <u>869,088</u>	\$ <u>15,584,104</u>	\$ <u>4,783</u>	\$ <u>4,072,111</u>	\$ <u>21,507,043</u>

<sup>1</sup> See note 11 on page A-21.

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules beginning on page A-15.

# Notes to the Financial Schedules

## For the Two Fiscal Years Ended June 30, 1996

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### 1. **Summary of Significant Accounting Policies**

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#### **Basis of Accounting**

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The department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental, Expendable Trust, and Agency Funds. In applying the modified accrual basis, the department records:

Revenues when it receives cash or when receipts are measurable and available to pay current period liabilities.

Expenditures for valid obligations when the department incurs the related liability and it is measurable.

State accounting policy also requires the department to record the cost of employees' annual leave and sick leave when used or paid.

The department uses accrual basis accounting for its Internal Service and Nonexpendable Trust Funds. Under the accrual basis, as defined by state accounting policy, the department records revenues in the accounting period earned if measurable and records expenses in the period incurred, if measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the department received the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

#### **Basis of Presentation**

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The financial schedule format is in accordance with the policy of the Legislative Audit Committee. For audit reports issued after July 1, 1996, the Legislative Audit Committee approved a new financial schedule presentation for agency audit reports. The schedules now include nonbudgeted revenue and expenditure activity and prior year revenue and expenditure adjustments for all financial schedules presented. In addition, financial activity for the Agency Funds is included in the Schedule of Changes in Fund Balances and Property Held in Trust.

## Notes to the Financial Schedules

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The financial schedules are prepared from the Statewide Budgeting and Accounting System without adjustment, except for agency funds which are adjusted to reflect the additions and reductions to property held in trust. Accounts are organized in funds according to state law. The department uses the following funds:

### Governmental Funds

**General Fund** - to account for all financial resources except those required to be accounted for in another fund.

**Special Revenue Fund** - to account for proceeds of specific revenue sources legally restricted to expenditures for specific purposes. Some of the department's State Special Revenue Fund accounts include funds related to Resource Indemnity Trust interest, Coal Severance Tax revenue, Forestry operations, Water Development bond proceeds, and Renewable Resource grants. Department Federal Special Revenue Funds include funds from the Departments of Energy, Interior, Agriculture, the Environmental Protection Agency, and Federal Emergency Management Agency.

**Debt Service Fund** - to account for accumulated resources for the payment of principal and interest on long-term debt. The department uses this fund for the bonds issued to provide funding for water development projects.

**Capital Projects Fund** - to account for resources used for purchase or construction of major capital facilities. The department uses this fund for the capitol building and long-range building project accounts. The activity accounted for in this account was formerly at the Department of State Lands and became part of DNRC with reorganization. (See note 5).

### Proprietary Funds

**Internal Service Fund** - to account for providing goods or services to other agencies or departments on a cost-reimbursement basis. The Department accounts for Air Operations in an Internal Service Fund. The activity accounted for in this account was formerly at the Department of State Lands and became part of DNRC with reorganization. (See note 5).

## Notes to the Financial Schedules

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### Fiduciary Funds

**Trust Funds** - to account for assets held by the State in a trustee capacity. The department's Expendable Trust Fund is related to the Rock Creek Trust agreement for mitigation of adverse effects of a power line which crosses Rock Creek. (In fiscal year 1995-96, this account moved to the Department of Environmental Quality. See note 5). The department's Nonexpendable Trust Funds are used to account for the Common School Permanent Trust, the Trust and Legacy, University and College Trusts, the Capitol Building Trust accounts and the Coal Severance Tax School Bond Contingency Fund.

**Agency Funds** - to account for assets held by the State as an agent for individuals, private organizations, other governments or other funds. The department records uncleared collections, property held in trust (PHIT), protested oil & gas royalties, and non-trust land activity in its Agency Fund.

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### 2. Annual and Sick Leave

Employees at the department accumulate both annual and sick leave. The department pays employees for 100 percent of unused annual and 25 percent of unused sick leave credits upon termination. Accumulated unpaid liabilities for annual and sick leave are not reflected in accompanying financial schedules. In the Proprietary Funds, the increase in annual and 25 percent of the increase in sick leave are recognized as nonbudgeted expenses when the related liability is recorded at year end. The department absorbs expenditures for termination pay in its annual operational costs. At June 30, 1996, the department had a liability of \$2,350,075.

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### 3. Pension Plan

Employees are covered by the Montana Public Employees' Retirement System (PERS). The department's net contribution to PERS was \$420,510 in fiscal year 1994-95 and \$870,088 in fiscal year 1995-96. The increase between fiscal years is mainly due to the increased the number of employees due to the reorganization which is discussed in note 5.

## Notes to the Financial Schedules

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4. **General Fund Balance** The General Fund is a statewide fund. Each agency does not have a separate General Fund since its only authority is to pay obligations from the statewide General Fund within their appropriation limits. Thus, on an agency's schedules, the General Fund beginning and ending fund balance will always be zero.
5. **Reorganization** The significant changes in revenues and expenditures and changes in fund balances between fiscal years 1994-95 and 1995-96 are mainly the result of reorganization changes. The 54th Legislature approved legislation which reorganized the Department of Natural Resources and Conservation (DNRC). As part of the reorganization, DNRC now administers the programs of the former Department of State Lands (DSL) except for the Reclamation Division which was transferred to the newly created Department of Environmental Quality (DEQ). In addition, the Energy Division programs formerly under DNRC were transferred to DEQ.
6. **Direct Entries to Fund Balance** The Schedule of Changes in Fund Balances and Property Held in Trust, contains direct entries to funds balances in the following funds.
- General Fund** Account balances in the department's General Fund relating to the former Energy Division were transferred to DEQ. Account balances from the former DSL were transferred to the department. The net effect of these transactions is a \$13,054,229 direct entry to General Fund balance in fiscal year 1995-96.
- Special Revenue and Debt Service Funds** The direct entry of \$923,674 to Special Revenue Fund balance and the direct entry of \$886,914 to Debt Service Fund balance in fiscal year 1994-95 are mainly related to funding water resource loans in the Special Revenue Funds and the moving the loan balances to the Debt Service Fund.
- The direct entry of \$151,552 to Special Revenue Fund balance and the direct entry of \$3,728,351 to Debt Service Fund balance in fiscal year 1995-96 relate to bond transactions for establishing loans and refunding of past bond issuances.



## Notes to the Financial Schedules

### Internal Service, Capital Projects and Non-expendable Trust Funds

The direct entries to fund balances in the Internal Service Fund, Capital Projects Fund and Nonexpendable Trust Fund in fiscal year 1995-96 relate to transfer of account balances from the former DSL to the reorganized DNRC.

### 7. Interfund and Intrafund Activity

The department pools the available cash in the permanent accounts and transfers it to an investment pool account. The department records investment earnings as revenue in the investment pool account. Subsequently, the investment earnings are distributed to the proper trust fund by recording a nonbudgeted transfer-out in the investment pool account and a nonbudgeted transfer-in to the respective trust accounts. Each permanent trust account also earns income from fees, rentals, and royalties. The trusts distribute this income to their respective beneficiaries (i.e., colleges, universities, institutions, and public schools). The following schedule summarizes the activity in the Nonexpendable Trust Fund.

	Fiscal Year <u>1994-95</u>	Fiscal Year <u>1995-96</u>
Investment Earnings	\$22,747,873	\$25,478,968
Trust Account Revenues	28,196,564	31,031,887
Transfers-In	<u>23,751,599</u>	<u>32,189,024</u>
Total Nonbudgeted Revenue and Transfers-In	<u>\$74,696,036</u>	<u>\$88,699,879</u>
Transfer of Investment Earnings to Trust Accounts	\$22,747,873	\$25,478,968
Transfer from trust to beneficiaries	<u>41,969,376</u>	<u>52,391,433</u>
Total Nonbudgeted Transfers-Out	<u>\$64,717,249</u>	<u>\$77,870,401</u>

These transfers include approximately \$27 million of transfers-in and transfers-out between trust funds which should be eliminated to arrive at unduplicated totals. The difference between revenue and transfers-in and transfers-out are revenues which by law remain in the trusts.

## Notes to the Financial Schedules

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**8. Cash Transfers** Several state agencies may record activity in the same accounting entity on SBAS. During the fiscal year, the activity for each agency is recorded on SBAS separately. At the end of the fiscal year, the cash for all agencies using the accounting entity is transferred to the administering agency.

**9. Nonbudgeted Activity** The majority of nonbudgeted revenues/expenditures and transfers-in/out activity in fiscal year 1994-95 and 1995-96 in the Special Revenue Funds and the Debt Service Funds are related to bond and debt service requirements administered in the Conservation and Resource Development Division.

**10. Bond Activity** The state of Montana issued general obligation bonds, the proceeds of which went to the department for loans related to wastewater and water conservation projects. During the audit period, the following general obligation bonds were issued:

	Fiscal <u>1995-96</u>	<u>Amount</u>	Fiscal <u>1995-96</u>	<u>Amount</u>
Wastewater Treatment	1994B	\$2,200,000	1996C	\$2,765,000
Renewable Resource Development	1994E	750,000	1996B	1,250,000
Energy Conservation Program	1994D	<u>1,600,000</u>		
Total		<u>\$4,550,000</u>		<u>\$4,015,000</u>

The department issued Coal Severance Tax (CST) 1996 Series A bonds for \$14,985,000. Of the proceeds, \$13,760,000 were used to refund the 1988 Series A, 1989 Series A, and 1990 Series B Water Development Program and \$1,225,000 was used to provide loans for projects. At June 30, 1996 the department had a total of \$58,581,818 of CST bonds outstanding.

Accounting entity transfers of \$16,450,387 on the Schedule of Total Expenditures, Transfers-Out & Other Reductions By Object By Program for fiscal year 1995-96 represent a transfer of CST 1996 Refunding Series A bond proceeds to the Debt Service Fund to refund the CST 1988 and 1989 Series A bonds and the CST 1990 Series B bonds.

## Notes to the Financial Schedules

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**11. Special Revenue Fund,  
Unspent Budget Authority  
and Budgeted Revenue  
Under Estimate**

Contributions on the Tongue River and Petrolia Dams did not begin until fiscal year 1995-96. As a result, the Schedules of Total Program Expenditures, Transfers-Out & Other Reductions By Object By Program show unspent budget authority in the Special Revenue Fund of approximately \$15.5 million in fiscal year 1994-95. The unspent budget authority in 1995-96 of approximately \$34.5 million represents biennial appropriations for the Tongue River and Petrolia Projects.

The Schedules of Total Revenues, Transfers-In and Other Additions show budgeted revenues under estimate for the federal and other financing sources Special Revenue Fund of approximately \$25.5 million and \$11.7 million, respectively. The federal revenue estimate relates to not receiving the anticipated money for Tongue River until the next fiscal year. The other financing sources estimate relates to an \$11 million loan anticipated to come from the Department of Interior, Bureau of Indian Affairs, to help fund the costs on the Tongue River Dam project.

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**12. Subsequent Events Bond  
Activity**

In conjunction with a Long Range Building Program Bond issuance, \$1,000,000 of General Obligations bonds were issued in August 1996. The bonds are Renewable Resource Bonds which are used to make loans to private parties for water development or renewable resource projects.

In December 1996, the department issued a 1996 Series D Coal Severance Tax (CST) bond anticipation note of \$1,375,000. The proceeds were used to make a loan to an irrigation district for necessary improvements to the system. This note will be refinanced by the next CST bond issue by the department.



# Agency Response

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DEPARTMENT OF NATURAL RESOURCES  
AND CONSERVATION



MARC RACICOT, GOVERNOR

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STATE OF MONTANA

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PO BOX 201601  
HELENA, MONTANA 59620-1601

March 10, 1997

Mr. Scott A. Seacat  
Legislative Auditor  
Room 135, State Capitol

Dear Scott:

I have reviewed your recommendations concerning the Financial Compliance Audit for the two fiscal years ended June 30, 1996 with my staff and have enclosed the Department of Natural Resources and Conservation's response to the recommendations.

My staff and I would like to thank you for the professional manner in which your staff conducted the audit and for the insight you provided to our programs.

Sincerely,

A handwritten signature in cursive script, appearing to read "Bud Clinch".

Bud Clinch, Director  
Department of Natural Resources & Conservation

Enclosure



RESPONSES TO RECOMMENDATION  
FINANCIAL COMPLIANCE AUDIT FOR FY95 AND FY96  
LEGISLATIVE AUDIT DIVISION

Recommendation #1:

We recommend the department review the accounting for the Air Operations Bureau in the Internal Service Fund to ensure accounting for assets and rates charged for aircraft use are in accordance with state law and policy.

Response We Concur: The department will review the accounting for the Air Operations Bureau and work with the Accounting Division to apply the proper accounting methodologies within the Internal Service Fund.

Recommendation #2:

We recommend the department:

- A. Properly distribute balances in uncleared collection accounts at fiscal year-end.
- B. Properly record property held in trust activity in the Agency fund.

Response A. We Concur: The department will endeavor to make the proper distributions beginning with fiscal year-end closing 1997.

B. We Concur: The definition of Agency Funds seems to be conflicting. The department will work with Accounting Division to record activity in Agency Funds in accordance with GAAP requirements.

Recommendation #3:

We recommend the department record earnings transactions in the Nonexpendable Trust Fund accounts in accordance with state accounting policy.

Response We Concur: The department will make an additional revenue accrual entry at fiscal year end to stay in accordance with GAAP.

Recommendation #4:

We recommend the department record Common School Permanent Trust Fund transfers in accordance with state accounting policy.

Response We Concur: The department will change methods of accounting for transfer activity to stay in accordance with GAAP.

Recommendation #5:

We recommend the department classify the Yellow Water Dam in compliance with state laws and regulations.

Response   We Concur:      The department will classify Yellow Water Dam within the next sixty days.